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SIPDIS

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SUBJECT: HIGH EXPECTATIONS FOR TURKEY'S NEW MORTGAGE LAW

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11. (U) Summary. In a social and economic watershed moment for Turkey, officials, real estate developers and finance experts are trumpeting the recent passage of a long-awaited mortgage law as an important step toward transforming Turkey's housing market and blighted urban landscape, a move that could potentially pave the way for millions of Turks to become first-time home owners. In addition to facilitating home ownership, the new law will be a boon to the banking and construction industries and may lead to substantial job-creation by energizing growth and investment in Turkey's real estate sector. Some local economists downplayed the impact of the new law's overall effect given still high interest rates and the absence of tax incentives for interest payments. End Summary.

MECHANICS OF REFORM

12. (U) After three years of preparation and delay, the Government submitted to parliament legislation earlier this year that would for the first time create a legal framework for mortgage lending. The legislation moved relatively quickly through the Budget and Planning Commission and was passed by the parliament on February 21. Deputy Prime Minister Abdulatif Sener heralded this "vital new mechanism" of reform as ushering a new era in Turkey, one in which average Turks will be encouraged to think "I will have a house." Short-term housing loans already existed in Turkey, but with the astronomical interest rates prevailing in high-inflation Turkey from the 1970's until very recently, Turks relied primarily on personal savings to finance home purchases. Far more commonly, they rent units in the uniform apartment blocks found throughout Turkish cities and towns or squat on public land. For the first time in many generations, mortgage financing will enable middle income families to achieve home ownership through installment payments approximately equal to current monthly rents.

13. (U) The new law requires consumers to pay one-fourth of a home's sale price up front and finance the remainder through long-term mortgage contracts with fixed or variable interest rates, in addition to requiring mandatory earthquake and life insurance for all homes purchased or sold. Only homes with municipality-issued certificates of occupancy will be eligible for mortgage loans under the new system. Consumers have the option to convert their existing housing loans to mortgage loans within three months of the new law's enactment.

14. (U) To help deal banks originate long-term funding, the law allows for the establishment of mortgage finance institutions to

which bank-issued mortgage loans may be sold. In the event of default for two consecutive installments, banks will give customers an extra month to make their payments before foreclosing. The law is thereby expected to make housing finance more attractive to financial institutions since it will make it easier for lenders to seize collateral. The law will also facilitate the creation of a secondary market in asset-backed securities issued by financial institutions and available for purchase on the Istanbul stock exchange to institutional investors, such as insurance companies and pension funds. By facilitating the creation of new, attractive assets, Sener asserted that the mortgage law will help Turkey attract more foreign investment.

RIPPLE EFFECT FROM LOANS

15. (U) Haluk Sur, one of Turkey's leading property developers and chairman of the Istanbul-based Association of Real Estate Investment Companies (GYODER), estimated that sixty percent of the country's 75 million inhabitants will benefit from the mortgage system. Sur predicts Turkey's annual housing loan market could reach 60 billion dollars once the mortgage system is fully operational.

16. (U) Many experts predict that new long-term financing will play a crucial role in creating much-needed employment opportunities, particularly in the construction sector. Manufacturers of cement, glass, home textiles, building materials, and steel may also hire additional laborers as the demand for housing increases. Others predict Turkey is poised to attract substantial foreign portfolio investment now that the law has passed. The requirement that mortgages obtain private earthquake insurance also will help ensure higher quality construction in a country plagued by weak enforcement of official building codes despite the high earthquake risk.

CRITICS WEIGH IN

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17. (U) Although the new law's passage has been widely praised, there are critics. The Consumer Protection Association and others said the law would not help low-income people afford housing. Some financial experts criticized the law's exclusion of tax incentives, and measures to encourage home ownership among salaried employees such as civil servants. The Finance Ministry opposed granting tax relief to mortgage borrowers because of the prospective loss of revenue. Minister of Economy Babacan said that other countries with mortgage tax breaks advised Turkey against including incentives in its legislation and the IMF opposed tax incentives. Ozgur Altug, an economist at Raymond James, noted that to make the new law effective, "interest rates will have to fall and interest payments will have to be tax deductible." Others adopt a wait-and-see attitude claiming it is too soon to assess the new law's potential until interest rates on bank loans come down from their current levels of more than 20 percent.

COMMENT

18. (U) The introduction of a mortgage system shows how far Turkey has come in creating a modern economy that meets the needs of consumers, as well as the work remaining to be done. As the rural migration to Turkey's urban centers steadily continues, and with half the country's population under the age of 25, demand for housing is only expected to grow over the next decade. The new opportunity for long-term financing, coupled with declining inflation, a growing economy, and falling interest rates, promises to provide growth opportunities for the housing, real estate and banking sectors. The mortgage law will also help Turkey's financial sector continue to deepen and modernize. There may also be additional opportunities for U.S. firms in niches like title insurance and asset-backed securitization.

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